(2)

No. 87-1718

Supreme Court, U.S.
FILED
JUL 29 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

In the Matter of:
ELLINGSEN MacLEAN OIL CO., INC.,
and related cases,

Debtors.

UNSECURED CREDITORS' COMMITTEE
and MOBIL OIL CORPORATION,

Petitioners,

v.

FIRST NATIONAL BANK & TRUST
COMPANY OF ESCANABA and
THE NORTHERN TRUST COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

DAVID F. HEROY
(Counsel of Record)
THOMAS C. WOLFORD
GARDNER, CARTON & DOUGLAS
321 N. Clark Street
Chicago, Illinois 60610-4795
(312) 644-3000
Counsel for Respondents

Of Counsel:
SNYDER, VALENTINE & RITCHIE
BUTCH, QUINN, ROSEMURGY, JARDIS & VALKANOFF

July 29, 1988

Pandick Midwest, Inc., Chicago • 733-6000

QUESTION PRESENTED

Whether an appeal from the Bankruptcy Court's financing order containing one disputed term was properly dismissed as moot where the order was not stayed pending appeal and the Respondents extended credit in good faith pursuant to Section 364(e) of the Bankruptcy Code, which unequivocally states that "the reversal or modification on appeal of an authorization under this section to obtain credit . . . does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, . . . unless such authorization . . . or the granting of such priority or lien, were stayed pending appeal."

PARTIES AND AFFILIATED CORPORATIONS

First National Bank & Trust Company of Escanaba is a subsidiary of Michigan Financial Corporation.

The Northern Trust Company is a subsidiary of the Northern Trust Corporation.

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
PARTIES AND AFFILIATED CORPORATIONS	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	iv
STATEMENT OF THE CASE	1
ARGUMENT	10
I. DISMISSAL OF THE APPEAL DOES NOT PRESENT AN ISSUE REQUIRING THIS COURT'S REVIEW	10
II. THE APPLICATION OF SECTION 364(e) TO THIS CASE DOES NOT ESTABLISH A PRECEDENT FOR ABUSIVE BANKRUPTCY PRACTICES	14
III. THE RECORD OF THIS CASE MAKES IT INAPPROPRIATE FOR REVIEW BY THIS COURT	17
IV. THE CIRCUITS ARE NOT IN CONFLICT ON THE ISSUE OF GOOD FAITH	18
V. THIS CASE DOES NOT PRESENT A CROSS COLLATERALIZATION ISSUE REQUIRING REVIEW BY THIS COURT	20
VI. PETITIONERS WERE NOT DENIED DUE PROCESS	26
VII. THE DECISION BELOW DOES NOT CONFLICT WITH DECISIONS OF THIS COURT	28
CONCLUSION	30

TABLE OF AUTHORITIES

Cases:	PAGE
In re Abbott Dairies of Pennsylvania, Inc., 788 F.2d 143 (3rd Cir. 1986)	18,19
In re Adams Apple, 829 F.2d 1484 (9th Cir. 1987)	11, 14, 18, 29
In re American Resources Management Corp., 51 Bankr. 713 (Bankr. D. Utah 1985)	13
In re Anderson Industries, Inc., 55 Bankr. 922 (Bankr. W.D. Mich., 1985)	4
In re Beker Industries Corp., 58 Bankr. 725, (Bankr. S.D.N.Y. 1986)	22
In re Borne Chemical Company, 9 Bankr. 263 (Bankr. N.J. 1981)	22
C.I.R. v. Engle, 464 U.S. 206 (1984)	13
Matter of EDC Holding Co., 676 F.2d 945 (7th Cir. 1982)	11, 13, 15
In re Ellingsen MacLean Oil Co., Inc., et al., 65 Bankr. 358 (W.D. Mich. 1986)	19, 26
In re Ellingsen MacLean Oil Co., Inc., et al., 834 F.2d 599 (6th Cir. 1987)	11, 13-15, 17, 19, 21, 26, 27, 29
In re FCX, Inc., 54 Bankr. 833 (Bankr. E.D. N.C. 1985)	13, 22
In re Flagstaff Foodservice Corp., 739 F.2d 73 (2nd Cir. 1984)	22
In re General Oil Distributors, Inc., 20 Bankr. 873 (Bankr. E.D.N.Y. 1982)	22
In re Monach Circuit Industries, Inc., 41 Bankr. 859 (Bankr. E.D. Pa. 1984)	23

	PAGE
Princeton University v. Schmid, 455 U.S. 100 (1982)	22
Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414 (1968)	29
Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979 (2d Cir. 1981)	4
Russello v. United States, 464 U.S. 16 (1983)	19
In re Texlon Corporation, 596 F.2d 1092 (2nd Cir. 1979)	3, 23
United States v. Lorenzetti, 467 U.S. 167 (1984)	19
In re Vanguard Diversified, Inc., 31 Bankr. 364 (Bankr. E.D. N.Y. 1983)	22
In the Matter of Xonics PhotoChemical, Inc., 841 F.2d 198 (7th Cir. 1988)	4
Statutes:	
Bankruptcy Reform Act of 1978, 11 U.S.C.	
§ 102(1)	26, 28
§ 361	3
§ 363(m)	11, 12
§ 364	8, 10-12, 14, 24-27, 29
§ 364(c)	28
§ 364(e)	1, 8-15, 17, 18 20, 23, 24, 28-30
§ 507	9
§ 544(b)	4
§ 548	3, 4

	PAGE
Rule 3007	27
Rule 7001	27
Rule 7052	21
Rule 9006(c)	28
Rule 9014	28
Rule 9023	15, 27
Rule 9024	15, 27
Bankruptcy Act of 1898	
§ 116(2)	25
§ 344	25
§ 446	25
Rule 805	12, 23
Mich. Comp. Laws	
§§ 566.11 et seq.	4
Federal Rules of Civil Procedure	
Rule 52(a)	21
Rule 59	27
Rule 60	27
Uniform Commercial Code	
§ 1-201(19)	19
Other Materials:	
Bohm, *The Legal Justification for the Proper Use of Cross-Collateralization Clauses in Chapter 11 Bankruptcy Cases*, 59 Am. Bankr. L. J. 284 (1985)	24
Carl, *Fraudulent Transfer Attacks on Guarantees in Bankruptcy*, 60 Am. Bankr. L. J. 109 (1985)	4
Comment, *Guarantees and Section 548 (a)(2) of The Bankruptcy Code*, 52 U. Chi. L. Rev. 194 (1985)	4

PAGE

H. Rep. No. 595, 95th Cong., 1st Session. 356-47 (1977) 26

Rosenburg, *Intercorporate Guaranties and The Law of Fraudulent Conveyances, Lender Beware,* 125 U. Pa. L. Rev. 235 (1976). 4

S. Rep. No. 989, 95th Cong., 2nd Session 57-58 (1978) 26

Stern, Gressman, and Shapiro, *Supreme Court Practice* 196 (1986) 19

Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy,* 60 S. Cal. L. Rev. 109 (1986) 24

Weintraub & Resnick, *Cross-Collateralization of Pre-petition Indebtedness as Inducement for Post-petition Financing: A Euphemism Comes of Age,* 14 U. C. C. L. J. 86 (1981) ... 24

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

In the Matter of:
ELLINGSEN MacLEAN OIL CO., INC.,
and related cases,

Debtors.

UNSECURED CREDITORS' COMMITTEE
and MOBIL OIL CORPORATION,

Petitioners,

v.

FIRST NATIONAL BANK & TRUST
COMPANY OF ESCANABA and
THE NORTHERN TRUST COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

STATEMENT OF THE CASE

This case involves the application of Section 364(e) of Title 11 of the United States Code (the "Bankruptcy Code"). The issue is whether the Petitioners were required to obtain a stay of a financing order entered in these cases in order to preserve their appellate rights with respect to that order.

This issue arises from proceedings in the United States Bankruptcy Court for the Western District of Michigan, Northern Division (the "Bankruptcy Court"), relating to thirteen commonly-owned oil companies (collectively, the "Debtors").

All of the Debtors were engaged in the retail sale of gasoline, fuel and home heating oil and were operated out of the same office by the same personnel as parts of one commingled, integrated business enterprise.[1] The Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code on February 6, 1984 (the "Petition Date").

The Unsecured Creditors' Committee (the "Committee") is the representative of the unsecured creditors in all thirteen Debtors' bankruptcy cases. It consists of eight members, all but one of which were suppliers of oil and gasoline to the Debtors. The Committee and one of its members, Mobil Oil Corporation, are the Petitioners herein.

The Northern Trust Company and the First National Bank & Trust Company of Escanaba (collectively, the "Banks") financed the Debtors beginning in 1981. The Banks made two types of loans to the Debtors: (a) loans from one of the Banks to a specific Debtor secured by specific property of that Debtor; and (b) a revolving, working capital loan to Bay de Noc Oil Co., one of the Debtors (the "Working Capital Loan").

Payment of the Working Capital Loan was guaranteed by each of the other twelve Debtors and secured by substantially all of the assets of each Debtor. All proceeds of the Working Capital Loan were deposited in a single bank account, and that bank account was used by all thirteen Debtors to (a) collect the proceeds of all of their accounts receivable and (b) purchase all of their inventory and pay all of their expenses. No records were kept showing which of the Debtors received what inventory. Therefore, separate balance sheets were not available for each of the Debtors.[2]

---

[1] Testimony of John Carey, Hearing on Motion for Substantive Consolidation, 10/16/84, Tr. 75-77.

[2] Carey, 10/16/84, Tr. 78-79. It was estimated that it would cost at least $50,000 in accountant's fees alone to determine whether separate balance sheets could be constructed. Testimony of Joseph Stojack, Hearing on Motion for Substantive Consolidation, 10/16/84, Tr. 134-139.

By the Petition Date, the Debtors had pledged all of their assets to the Banks as security either for one or for both types of loans. The Banks' claims at that time were approximately $4.4 million, including $2.8 million due under the Working Capital Loan.

On March 31, 1984, the Bankruptcy Court entered an order (the "Cash Collateral Order") authorizing the Debtors to obtain additional post-petition secured credit from the Banks. This order did not grant the Banks additional security or priority for any pre-petition unsecured claims. It therefore did not cross-collateralize any of the Banks' claims.[3] The Cash Collateral Order also authorized the Debtors to incur trade debt of up to $750,000 on fifteen day terms from Enterprise Oil Co. ("Enterprise") secured by a purchase money security interest senior to the Banks' interests.

The combination of additional financing from the Banks plus trade credit from Enterprise was necessary for the Debtors to continue their business operations.

Shortly after the Petition Date, Petitioners orally asserted that the obligations of the twelve Debtors (other than the Bay de Noc Oil Co.) which guaranteed the Working Capital Loan might be avoided as fraudulent transfers under Section 548 of the Bankruptcy Code because those twelve Debtor-guarantors did not receive "reasonably equivalent value" in exchange for

---

[3] Cross-collateralization means that in return for making post-petition loans, a lender obtains a security interest in all of the debtor's assets, both pre-petition and post-petition, not only for the post-petition loans but for pre-petition unsecured indebtedness as well. *See In re Texlon Corp.*, 596 F.2d 1092, 1094 (2nd Cir. 1979). *See also* discussion *infra* at 20-22. The Cash Collateral Order did grant the Banks "replacement liens" on all of the Debtor's assets to the extent that the Banks had otherwise valid claims secured by those assets. Replacement liens, however, are expressly authorized by Section 361 of the Bankruptcy Code as one form of "adequate protection" for a secured creditor's property interest.

their guarantees.[4] Petitioners never reduced their theories to writing, nor did they choose to test them in litigation.[5]

---

[4] The fact that one corporation guarantees a debt of another, commonly-owned corporation does not necessarily mean that the guarantor did not receive "reasonably equivalent value" for its guaranty. A determination of whether a corporation receives "reasonably equivalent value" for its guaranty of a debt of its commonly-owned affiliate requires an analysis of both direct and indirect (based on common ownership and management) benefits received by the guarantor. Rosenberg, *Intercorporate Guaranties and the Law of Fraudulent Conveyances: Lender Beware*, 125 U. Pa. L. Rev. 235 (1976); Comment, *Guarantees and Section 548(a)(2) of the Bankruptcy Code*, 52 U. Chi. L.Rev. 194 (1985); *See e.g., Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 990 (2d Cir. 1981). Section 548(a)(2) also requires that, in addition to proving a debtor's receipt of less than a "reasonably equivalent value" for an obligation, a trustee must establish the debtor's insolvency or similar financial condition at the time the obligation was incurred. Proof of financial condition includes not just a balance sheet analysis, but consideration of (a) the probability of the guarantor being required to pay; and (b) the value of the paying guarantor's equitable rights against the obligor and any other co-guarantor in the event that the guarantor is required to pay. *See, e.g., In the Matter of Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988); Carl, *Fraudulent Transfer Attacks on Guaranties in Bankruptcy*, 60 Am. Bankr. L.J. 109, 115 (1985). Furthermore, Section 548 applies only to obligations incurred within one year prior to the Petition Date. The Debtors' obligation to repay the Working Capital Loan arguably arose in 1981. Accordingly, that obligation may be beyond the reach of Section 548.

Section 544(b) of the Bankruptcy Code might permit an avoidance action to be brought under the Uniform Fraudulent Conveyance Act—with a six year statute of limitations—as adopted by the State of Michigan. Mich. Comp. Laws §§ 566.11 et seq. (1979). Absent proof of actual intent to defraud creditors, Michigan law may require proof that a creditor of the bankruptcy estate was unpaid at the time of the conveyance. *See In Re Anderson Industries, Inc.*, 55 Bankr. 922 (Bankr. W.D. Mich. 1985).

[5] On July 30, 1984, the Committee did file a one-page, general objection to the Banks' claims that alleged, *inter alia*, that the Banks "may have been" the recipients of voidable transfers. The Committee never requested a hearing on its objection.

Then, two months after the Petition Date, the Debtors moved for substantive consolidation. Substantive consolidation would have merged all thirteen Debtors into one debtor having all of the assets and liabilities of all of the Debtors, thereby precluding any possibility that one Debtor did not receive "reasonably equivalent value" for its guaranty of another Debtor's obligations. After two days of evidentiary hearings, the Bankruptcy Court denied the motion, although it found that the Debtors' operations and assets were "hopelessly mixed-up."[6] The Banks have appealed the denial of this motion to the District Court.

As the Debtors' bankruptcy proceedings continued, their financial condition deteriorated. The Debtors lost their only supplier of inventory on credit terms when Enterprise filed its own Chapter 11 petition in late 1984. Although the Banks had advanced more than an additional $500,000 secured credit after the Petition Date to the Debtors, the Debtors incurred substantial operating losses. In October, the Debtors defaulted on their obligations under the Cash Collateral Order to make monthly adequate protection payments to the Banks as a condition of the Banks' post-petition financing.

On or about December 1, 1984, the Debtors sought additional financing from the Banks in order to preserve their operations through the winter heating oil season. The Banks were unwilling to advance additional funds on the same terms and conditions that the Debtors previously had been unable to fulfill. The Debtors did not have any additional collateral to offer, and the collateral base of the Banks was being depleted by the Debtors' continuing losses. It was unclear whether the value of the Debtors' assets would be sufficient to pay the Banks' secured claims. After weeks of negotiation with the

---

[6] Opinion Denying Substantive Consolidation, December 19, 1984, at 3. The order was entered without prejudice to the Banks' right to renew the motion.

Debtors concerning additional funding, the Banks filed a motion for relief from the automatic stay to foreclose on their security interests and to prohibit the Debtors' continued use of the Banks' cash collateral.

On December 20, 1984, the Debtors filed a verified Petition for Authority to Settle Stay Litigation, to Amend the [Cash Collateral] Order and to Obtain New Credit (the "Verified Motion"). The Debtors initially requested a finding that an emergency situation existed because they had run out of cash, could not purchase additional inventory and could not fill orders from their customers. The Bankruptcy Court entered an order that day, scheduling an emergency hearing for the following day and immediately giving telephonic notice thereof to the Banks, the Committee, Mobil and certain other creditors.

On December 21, 1984, the Bankruptcy Court held a hearing to consider the Verified Motion. Counsel for the Debtors appeared in court with two witnesses while counsel for the Petitioners, the Banks and one other creditor participated by telephone. All parties argued and cross-examined witnesses.

The undisputed testimony was that the Debtors had run out of cash and could not obtain additional financing from any other source. Unless the Debtors immediately obtained financing to purchase inventory, they would be forced to close their operations. The Banks were willing to provide additional financing only if any future claims of the Debtors based on the fraudulent transfer theories of the Petitioners were waived. The Bankruptcy Court concluded that it had to "face reality that if

the debtor doesn't have this financing, he is going to lose a substantial portion of the business .... I'm going to grant the debtor the relief requested ... for the purpose of securing the additional credit needed by the Debtor to get through the heating oil season and to preserve the entities in Marquette as going concerns."[7]

On December 22, 1984, the Bankruptcy Court entered the Amended Order Authorizing the Debtors to Obtain Credit (the "Amended Order"). It authorized the Debtors to obtain additional post-petition credit from the Banks and approved the Debtors' waiver of potential challenges to the validity of the Banks' claims based on Petitioners' fraudulent transfer theories.

At that time, the Bankruptcy Court was aware that the Debtors would have manifest problems in applying Petitioners' fraudulent transfer theories to the Banks' claims, that the prosecution of these theories would cost the Debtors at least $150,000-$250,000, and that the Debtors had no funds to pay for the litigation. Having heard two days' evidence at the hearing on the Debtors' motion for substantive consolidation, the Bankruptcy Court also was aware of testimony that the thirteen Debtors operated as one commingled enterprise—testimony that by itself would preclude the application of Petitioners' theories to this case.[8] The Bankruptcy Court therefore found that Petitioners' theories had "little likelihood" of success.[9]

---

[7] Hearing on Verified Motion, 12/21/84, Tr. 68-69.

[8] Since all of the Debtors had equal access to and use of the Working Capital Loan, it would be virtually impossible to prove that any particular Debtor did not receive "reasonably equivalent value" for its guaranty.

[9] Petitioners repeatedly charge that the Bankruptcy Court's findings of fact in the Amended Order are "baseless." Petition at 5, 6 and 12. The example of a "baseless finding" cited by Petitioners is this finding of "little likelihood" that these theories would be successful.

(Footnote continued on following page.)

The Amended Order also continued the provisions of the Cash Collateral Order which did not cross-collateralize the Banks' claims. Pre-petition assets of the Debtors in which the Banks did not have a perfected pre-petition security interest were defined as "Free Assets" and could serve as collateral only for post-petition advances by the Banks.

The Amended Order stated that it was entered pursuant to Section 364 of the Bankruptcy Code, and that the "validity of any credit extended by the Banks and any priority or lien granted pursuant to this order shall not be affected on appeal . . . unless this Order is stayed pending appeal,"[10] quoting Section 364(e).

Petitioners did not seek an immediate stay pending appeal. The Banks initially extended new credit in the amount of $60,000 and eventually made credit of $175,000 available to the Debtors in the form of irrevocable letters of credit for the purchase of heating and fuel oil.

If the Amended Order had not been entered, no additional financing would have been forthcoming, the Debtors' operations would have ceased immediately, and the Debtors' assets would have been liquidated without regard to the going concern value of the business. In that event, there would have been no payment whatsoever to unsecured creditors because

---

(Footnote continued from preceding page.)

Petition at 6, n. 6. This finding is, however, amply supported by (a) the numerous legal defenses to such an action (*see* discussion *supra* at n. 4); (b) the statements in the Verified Motion; (c) the testimony at the hearing on the Verified Motion; and (d) the testimony at the hearing on the substantive consolidation motion referred to by the Bankruptcy Court in Paragraph 15 of the Amended Order.

[10] Amended Order, para. (o).

$3.3 million in priority tax claims had been filed against the Debtors.[11] All creditors therefore benefited from entry of the Amended Order.

The Petitioners appealed the Amended Order after the Banks extended credit. Not until July 5, 1985—more than six months after the Bankruptcy Court had entered the Amended Order and well after the Banks had extended additional credit—did Petitioners move for a stay pending appeal. Petitioners did not offer to post a bond in connection with their motion, and the Bankruptcy Court denied it.

The Banks then moved to dismiss the appeal under Section 364(e) on the ground that the Banks had extended credit in good faith pursuant to the Amended Order, which had not been stayed pending appeal. Finding that the Banks had extended credit to the Debtors in good faith pursuant to the Amended Order, the District Court entered an order (the "Dismissal Order") dismissing the appeal. The Court of Appeals affirmed the Dismissal Order. It is the Dismissal Order that is the subject of this petition.

---

[11] Amended Order, para. 11. The logical inference from this finding is that the Committee's objections may be moot insofar as the unsecured creditors are concerned. This suggests that the real parties in interest here may be administrative claimants, such as counsel for the Committee, that would be paid before tax claimants under Section 507 of the Bankruptcy Code.

ARGUMENT

Petitioners request that their petition be granted so that this Court may resolve "whether the Bankruptcy Code allows the use of cross-collateralization financing orders." Their petition is replete with arguments concerning the substantive merits of cross-collateralization. Those arguments, however, are irrelevant. The issue here is whether the District Court properly dismissed Petitioners' appeal as moot because Petitioners failed to comply with the stay requirement of Section 364(e). It is not whether the Bankruptcy Code permits cross-collateralization.

I. DISMISSAL OF THE APPEAL DOES NOT PRESENT AN ISSUE REQUIRING THIS COURT'S REVIEW.

The decision below was a straightforward application of the plain language of the statute. The Debtors had obtained credit under the Amended Order expressly entered pursuant to Section 364. Section 364(e) applies its stay requirement to authorizations "under this section." Petitioners did not obtain a stay pending appeal, and the Banks advanced credit in good faith. This is hardly an important federal question.

A. The Stay Requirement Of Section 364(e) Applies Regardless Of Whether A Financing Order Contains A Disputed Term

Petitioners argue that their appeal was dismissed improperly because the Amended Order provided for the Debtors' waiver of objections based on fraudulent transfer theories about the Banks' claims. In particular, Petitioners argue that this waiver amounted to cross-collateralization of the Banks' claims, that cross-collateralization is not permitted by the Bankruptcy Code, and that the stay requirement of Section 364(e) cannot apply to an order containing such a term.

The Amended Order did not provide for cross-collateralization. The Banks neither received additional secu-

rity nor were granted priority for any pre-petition unsecured claim. In any event, cross-collateralization is not prohibited by the Bankruptcy Code. *See* discussion *infra* at 20-26.

But this Court does not even have to reach those questions here. The case law unanimously holds that the stay requirement of Section 364(e) applies regardless of whether a financing order contains a disputed term. Both the Sixth Circuit in the opinion below and the Ninth Circuit in *In re Adams Apple* applied Section 364(e) to dismiss appeals despite arguments that certain aspects of the financing orders may have contained terms other than the liens and priorities expressly set forth in Section 364.[12] Therefore, there is no controversy in the courts about this application of Section 364(e) that requires review by this Court.

There are strong policy reasons for applying Section 364(e) in this manner. In *Matter of EDC Holding Co.*, the Seventh Circuit examined Congressional policy and concluded that:

> These provisions [Sections 363(m) and 364(e)] seek to overcome people's natural reluctance to deal with a bankrupt firm whether as purchaser or lender by assuring them that so long as they are relying in good faith on a bankruptcy judge's approval of the transaction they need not worry about their priority merely because some creditor is objecting to the transaction and is trying to get the district court or the court of appeals to reverse the bankruptcy judge. *The proper recourse for the objecting creditor is to get the transaction stayed pending appeal.*

Matter of EDC Holding Co., 676 F.2d 945, 947 (7th Cir. 1982) (emphasis added).

This policy recognizes the difficulties inherent in Chapter 11 reorganizations. Chapter 11 contemplates the continued

---

[12] *Ellingsen-MacLean Oil Co., Inc.*, 834 F.2d 599, 603 (6th Cir. 1987); *In re Adams Apple, Inc.*, 829 F.2d 1484, 1488 (9th Cir. 1987).

operation of a debtor's business. Operating a troubled business almost inevitably requires the infusion of fresh capital. But lenders may be reluctant to extend credit to a Chapter 11 debtor, and sellers may refuse to ship goods except on a cash basis. By the time of the filing of a Chapter 11 petition, a debtor may have few, if any, unencumbered assets remaining to offer as collateral for post-petition extensions of credit. Hence it may be difficult, if not impossible, for the debtor to raise fresh funds or make credit purchases absent some incentive to potential creditors.

Before extending credit to a debtor, a lender must be certain that its bargained-for conditions cannot be reversed on appeal. Section 364(e) provides that certainty and enables a debtor to receive new funds that might not otherwise be made available at a time when the debtor's survival may be in jeopardy.

Congress deemed these protections to be an appropriate *quid pro quo* for the lender that advances funds to a debtor. To invalidate any of the terms of an agreement after the lender already has extended credit would deter any lender from advancing funds to a Chapter 11 debtor. Accordingly, Congress decreed that unless such an order is stayed pending appeal, it will survive any appeal.[13]

This requirement is more than a procedural nicety. As a bankruptcy court observed:

> A lender makes advances in reliance upon such orders authorized by § 364 and "(t)he chapter 11 process would be undermined if this Court were to, in effect, undo those orders . . . ."

---

[13] Congress provided similar protections to purchasers of a debtor's property in Section 363(m) of the Bankruptcy Code. Sections 364(e) and 363(m) are substantially the same as Rule 805 of the Rules of Bankruptcy Procedure in effect under the Bankruptcy Act of 1898.

In re FCX, Inc., 54 Bankr. 833, 838 (Bankr. E.D.N.C. 1985) (quoting *In re American Resources Management Corp.*, 51 Bankr. 713, 722 (Bankr. D. Utah 1985)).

The Sixth Circuit in the opinion below reiterated that Section 364(e) was intended to protect "the lender who believes his priority is valid but cannot be certain that it is because of objections that might be upheld on appeal."[14] In other words, this Congressional policy is so important that it applies even where there is a chance that the merits of the underlying order could be challenged successfully. The logic of this conclusion is compelling. A stay requirement provides no certainty if its application depends on the validity of the underlying order itself.

Petitioners would have this Court ignore logic and Congressional policy to go directly to the merits of the Amended Order in order to determine whether the stay applies at all. That result would completely frustrate the Congressional goal of providing certainty to post-petition lenders and would seriously impair the ability of debtors to obtain financing and reorganize. A basic rule of statutory construction is that a statute is to be interpreted harmoniously with its scheme and the general purposes Congress manifested, not in contradiction thereof. *C.I.R. v. Engle*, 464 U.S. 206, 217 (1984).

B. The Stay Requirement of Section 364(e) Is Not Limited To Post-Petition Advances

Petitioners also argue that the stay requirement of Section 364(e) should be limited to protecting only the Banks' post-petition advances, not the entire Amended Order. No court has ever limited Section 364(e) in this manner because to do so would undercut the Congressional goal of providing incentives to a creditor to extend post-petition credit.

---

[14] *Ellingsen-MacLean Oil Co., Inc.*, 834 F.2d at 604, quoting the Seventh Circuit in *Matter of EDC Holding Co.*, 656 F.2d at 947.

As this case illustrates, the economic difference in changing one term of a financing order after the fact can be substantial. The Banks claimed a first lien on all of the Debtors' assets, and no new collateral was available. Under these circumstances, the Banks could not have been expected to extend more credit unless they received protection beyond their new advances. As the Sixth Circuit stated in rejecting this argument in the opinion below, "if Section 364(e) protection were limited in all cases to new advances, creditors might not be willing to extend more credit, and debtors would fail, probably after depletion of assets and collateral; all creditors would be losers in that situation." 834 F.2d at 604.

II. THE APPLICATION OF SECTION 364(e) TO THIS CASE DOES NOT ESTABLISH A PRECEDENT FOR ABUSIVE BANKRUPTCY PRACTICES.

According to Petitioners, applying the stay requirement of Section 364(e) in this manner prevents appellate courts from ever hearing the merits of questionable financing orders. Petitioners then argue that this will result in "future abuse" of unsecured creditors.

A. There Are Ample Procedural Safeguards For Persons Aggrieved By Section 364 Financing Orders

Petitioners' speculative argument initially ignores the procedural framework of Section 364. The Bankruptcy Court approved the Amended Order only after notice and a hearing and upon a finding that the proposed financing arrangement was in the best interests of the estate. The Bankruptcy Court, being familiar with the case and the evidence placed before it, was best situated to make this determination. As the Ninth Circuit stated in *Adams Apple*, "the authority [to allow cross-collateralization under Section 364] is best lodged in the bankruptcy judge . . . a judge's authorization after appropriate notice and hearing, would represent a reasoned judgment based on the best interests of all parties involved." 829 F.2d at 1491.

Petitioners surely do not suggest that bankruptcy courts are incapable of making such determinations without "abusing" unsecured creditors. The numerous reported bankruptcy decisions that carefully weigh all competing interests before allowing financing orders containing cross-collateralization belie Petitioners' arguments. *See* discussion *infra* at 22.

Persons aggrieved by financing orders are further protected by the good faith requirement of Section 364(e). To qualify for the protection of Section 364(e), a lender must extend credit in good faith. As the Sixth Circuit stated in the opinion below," [t]his good faith requirement allays creditors' concerns about abuse of the process." 834 F.2d at 603. In fact, the Seventh Circuit vacated a bankruptcy court's financing order on precisely this basis in *Matter of EDC Holding Co.*, 676 F.2d at 949.

Unsecured creditors also can challenge an objectionable financing order in a number of ways, most directly by obtaining a stay pending appeal.[15] Notably, neither the Committee nor Mobil has claimed that it would have been unable to obtain a stay here had it sought one in a timely fashion.

Section 364(e) may impose a stay requirement on appellants, but it furthers the Congressional policy of providing certainty to lenders. That is a choice that has been made by Congress and should not be disturbed by the courts.

B. No Abusive Bankruptcy Practices Occurred As A Result Of The Decisions Below

Petitioners also ignore the facts in this record. The Banks requested a commercially reasonable *quid pro quo* for extending additional financing at considerable additional risk. The result

---

[15] Other procedural options available to an aggrieved party are to move for a new trial under Bankruptcy Rule 9023 or for relief from the financing order under Bankruptcy Rule 9024. Petitioners, though they claim to have been denied due process, failed to follow any of those procedures here. *See* discussion *infra* at 26-27.

was the preservation of the Debtors' going concern value to everyone's benefit, not an "abuse of unsecured creditors" requiring this Court's review.

The Debtors were out of funds and were in default under the Cash Collateral Order. The Banks' collateral was being depleted by the Debtors' losses, and the Banks were unsure whether the value of all of the Debtors' assets was sufficient to satisfy their secured claims. No additional collateral was available to secure the additional financing that the Debtors requested, and the Banks were unwilling to continue financing the Debtors while faced with the prospect of defending costly litigation about the validity of their claims. Any prudent lender would have requested a release of those claims prior to advancing additional credit, regardless of whether its borrower was in Chapter 11.

To be sure, the result was a release of potential claims based on Petitioners' fraudulent transfer theories. But there was ample justification for the Bankruptcy Court's finding that this was in the "best interests of these estates and their creditors."[16] Petitioners' theories were untested, presented several legal problems of proof and were virtually precluded by testimony that the Bankruptcy Court had heard at an earlier hearing. Moreover, the Debtors did not have sufficient funds to pay the substantial projected initial costs of litigation. On the other hand, the Debtors received $175,000 in additional credit and preserved their going concern value to benefit all creditors, including Petitioners.

Petitioners deliberately refrained from obtaining a stay of the Amended Order and preventing the Banks from advancing additional credit. In fact, the proceeds of the additional credit were paid to trade suppliers who would not themselves extend additional credit. Yet Petitioners, including the Committee

---

[16] Amended Order, para. 15.

which represents those same trade suppliers, now argue that they should retain the benefit of the Banks' additional financing while depriving the Banks of their part of the bargain. Petitioners cannot have it both ways. The Banks were entitled to finality once they advanced additional credit. This is a fair result dictated by Section 364(e) and the Congressional policy of providing certainty to lenders, not an "abuse of unsecured creditors."

III. THE RECORD OF THIS CASE MAKES IT INAPPROPRIATE FOR REVIEW BY THIS COURT.

Other aspects of this case make it particularly ill-suited for review by this Court. The Sixth Circuit deliberately limited the effect of its holding. In his concurring opinion, Judge Nelson wrote separately "to emphasize the limited precedential effect of our holding in this case." 834 F.2d at 605-606. In short, there is no danger that the Sixth Circuit or the lower courts have established the "broad precedent" that Petitioners fear.

Petitioners' failure to put their theories to a test by prosecuting their objections to the Banks' claims and their subsequent failure to obtain a stay as required by Section 364(e) are facts that influenced both of the decisions below. As Judge Nelson stated:

> The unsecured creditors having been made aware of the bankruptcy court's position that under Section 364(e) the validity of the replacement liens would not be affected by reversal on appeal unless the amended order were stayed, it seems to me that the unsecured creditors acted at their peril in failing to obtain such a stay.

834 F.2d at 606.

Petitioners' failure to act makes this case particularly inappropriate for consideration by this Court. The record in this case is clouded by Petitioners' cavalier attitude towards the express requirements of the Bankruptcy Code and the Bank-

ruptcy Rules. These facts may not exist in other cases presenting Section 364(e) issues, thereby making those cases more appropriate for this Court's consideration.

Also, this Court also should not hear an issue that may be rendered moot by another ruling in the same case. If substantive consolidation is ordered for these cases, Petitioners' alleged fraudulent conveyance theories would evaporate. This case then would be devoid of any possible argument that Section 364(e) was improperly applied.

IV. THE CIRCUITS ARE NOT IN CONFLICT ON THE ISSUE OF GOOD FAITH.

Petitioners argue that the opinion below creates a conflict in the Circuit Courts of Appeal as to what constitutes "good faith" under Section 364(e), and that this Court should resolve that conflict at this time.[17] Section 364(e) protection is limited to lenders that advance credit in "good faith"—a term that is not defined in the Bankruptcy Code. The Sixth Circuit affirmed the lower courts' findings that the Banks advanced credit in good faith.

There is no conflict in the circuits here. No court of appeals has stated that its standard of "good faith" is at odds with a standard of a different circuit. Indeed, in *In re Adams Apple, Inc.*, the Ninth Circuit cited a series of standards —including the two that Petitioners now allege to be in conflict—without indicating that there was any conflict at all.[18]

The good faith standards of the Third and Sixth Circuits questioned by Petitioners do not even rise to the level of

---

[17] Petitioners argue that the Sixth Circuit's application of the good faith requirement of Section 364(e) conflicts with the Third Circuit's decision in *In re Abbott Dairies of Pennsylvania, Inc.*, 788 F.2d 143 (3rd Cir. 1986).

[18] *See In re Adams Apple, Inc.*, 829 F.2d at 1489.

inconsistent dicta or general principles.[19] In the opinion below, the Sixth Circuit noted that the definition of good faith most often used in bankruptcy cases is that of Uniform Commercial Code Section 1-201(19): "[G]ood faith means honesty in fact in the conduct or transaction concerned." 834 F.2d at 605. The Third Circuit stated that the misconduct that would destroy a purchaser's good faith "involves fraud, collusion ... or an attempt to take grossly unfair advantage of other bidders." 788 F.2d at 147. The Third Circuit's *Abbott Dairies* type of misconduct would not be "good faith" under the "honesty in fact in the conduct or transaction concerned" standard of the Sixth Circuit, and *vice versa.*

Finally, the lower court's finding that the Banks advanced credit in good faith can be reached under the standard suggested by Petitioners. In fact, both the District Court and Sixth Circuit in effect applied the *Abbott Dairies* standard to the facts of this case. There was no question that the Banks extended credit in good faith because its proceeds were used to purchase inventory and preserve the going concern value of the business. Both courts rejected Petitioners' assertions that the Banks had conspired to defraud the Debtors and then had duped both the Debtors and Bankruptcy Court into the agreement. As the District Court stated, "there are no plain facts on the record which could support a finding of a 'bank conspiracy.' "[20]

---

[19] Granting a petition to resolve a conflict in circuits has been reserved to those situations presenting squarely or intolerably conflicting opinions on the same matter of law or fact, "not merely an inconsistency in dicta or in the general principles utilized." Stern, Gressman and Shapiro, *Supreme Court Practice* 196 (1986); *see also Russello v. United States*, 464 U.S. 16, 18 (1983), and *United States v. Lorenzetti*, 467 U.S. 167 (1984), where even the courts of appeals recognized that their holdings were in square conflict with each other.

[20] *Ellingsen-MacLean Oil Co., Inc., et al.*, 65 Bankr. 358, 363 (W.D. Mich. 1986); *see also* 834 F.2d at 605. Petitioners nevertheless continue to assume that the Banks "precipitated the emergency nature of the hearing." Petition at (i). There is no support whatsoever in the record for this allegation, and it is directly contrary to the findings of the lower courts.

V. THIS CASE DOES NOT PRESENT A CROSS-COLLATERALIZATION ISSUE REQUIRING REVIEW BY THIS COURT.

According to Petitioners, the Debtors' waiver of potential objections based on fraudulent transfer theories is impermissible because it constituted improper cross-collateralization of the Banks' claims. Petitioners then argue that this Court should resolve the "important federal question" of whether cross-collateralization is permitted under the Bankruptcy Code.

This Court, however, will never reach the merits of cross-collateralization here. At issue is only whether the appeal was dismissed properly under Section 364(e). If this Court decides that the Amended Order was dismissed improperly, it will reverse the Dismissal Order and remand the matter to the lower courts for consideration of the merits of the Amended Order.

The only possible relevance of cross-collateralization is Petitioners' argument that the stay requirement of Section 364(e) was applied improperly because the Amended Order contains an impermissible cross-collateralization term. But as discussed *supra* at 10-13, the stay requirement of Section 364(e) applies despite the presence of a disputed term in a financing order. Therefore, under the proper interpretation of Section 364(e), the propriety of cross-collateralization remains irrelevant here.

Even under Petitioners' incorrect and narrow view of Section 364(e), there is no cross-collateralization issue for this Court's review. The Amended Order does not contain cross-collateralization terms. Even assuming that it does, this Court would find that there is no serious controversy in the lower courts about cross-collateralization, and that cross-collateralization should be permitted to the extent it actually occurred here.

A. This Is Not A Cross-Collateralization Case

The Amended Order did not provide for cross-collateralization because the Banks did not receive additional

collateral or priority status for any pre-petition unsecured claim. The Banks' pre-petition advances were secured only by those assets in which the Banks enjoyed a perfected pre-petition security interest. The Debtors' other assets were defined as "Free Assets" and could be security only for post-petition advances by the Banks.

This is a very important distinction. The essence of the "important federal issue" alleged by Petitioners is the securing of a pre-petition unsecured claim with a debtor's post-petition assets in preference to other unsecured claims. Since the Amended Order did not have that effect, the issue posed by Petitioners is not even present here. The Sixth Circuit agreed with this conclusion in the opinion below, holding that the Amended Order "did not create any new lien as such securing pre-petition debt; rather, at most, it further secures pre-petition debt by prohibiting any challenges to the pre-petition security interests." 834 F.2d at 604.

Only by assuming that a fraudulent transfer theory which was never pursued would have been sustained as an objection to the Banks' claims after an evidentiary hearing could this Court find that the Amended Order possibly presents a cross-collateralization issue. That assumption cannot be made here. The Bankruptcy Court found that the objection had "little likelihood" of success and would have been prohibitively expensive for the Debtors to litigate. It also found that the additional financing provided by the Banks on these terms was in the best interest of these estates. These are findings of fact which should not be disturbed unless "clearly erroneous."[21]

Even if the Bankruptcy Court was wrong and there was some merit to Petitioners' theories, the Amended Order should not be considered to be a cross-collateralization order. A

[21] Fed. R. Civ. P. 52(a); Bankruptcy Rule 7052.

release of objections based on one untested legal theory does not amount to securing previously unsecured pre-petition debt.

This case simply does not have any cross-collateralization issues. Consequently, any opinion rendered on that issue on the basis of these facts would be only advisory. This Court, of course, should avoid rendering such an opinion. *Princeton University v. Schmid,* 455 U.S. 100, 102 (1982).

B. There Is No Serious Controversy In The Lower Courts About Cross-Collateralization

Nor is cross-collateralization, as Petitioners suggest, an important federal issue deserving of this Court's attention. Although a few lower courts have described it as "controversial" or "disfavored," the federal courts unanimously have held that it may be permitted.[22]

No court ever has held that cross-collateralization cannot be permitted. Only two courts have even suggested that cross-

---

[22] *See, e.g., In re Borne Chemical Company,* 9 Bankr. 263 (Bankr. D.N.J. 1981); *In re General Oil Distributors, Inc.,* 20 Bankr. 873 (Bankr. E.D.N.Y. 1982); *In re Flagstaff Foodservice Corp.,* 14 Bankr. 462 (Bankr. S.D.N.Y. 1981); *In re FCX, Inc.,* 54 Bankr. 833 (Bankr. E.D.N.C. 1985); *In re Beker Industries Corp.,* 58 Bankr. 725 (Bankr. S.D.N.Y. 1986). In considering cross-collateralization, most courts inquire whether (1) absent the proposed financing, the debtor's business operations will not survive; (2) the debtor is unable to obtain alternative financing on acceptable terms; (3) the proposed lender will not accede to less preferential terms; and (4) the proposed financing is in the best interests of the general creditor body. *In re Vanguard Diversified, Inc.,* 31 Bankr. 364 (Bankr. E.D.N.Y. 1983).

Each of those factors is present here. In the Verified Motion, the Debtors stated that unless they received additional funds, their

(Footnote continued on following page.)

collateralization provisions may be improper, and then only in *dicta*. *In re Texlon Corp.*, 596 F.2d at 1098; *In re Monach Circuit Industries*, 41 Bankr. 859 (Bankr. E.D. Pa. 1984). Moreover, both of those cases contain facts that distinguish them from this case.

In *Texlon*, a case decided under the Bankruptcy Act of 1898, the bankruptcy court entered an *ex parte* financing order on the same day the bankruptcy petition was filed. In reversing the entry of that order, the Second Circuit held:

> [I]n order to decide this case we are not obliged, however, to say that under no conceivable circumstances could "cross-collateralization" be authorized. Here it suffices to hold that . . . a financing scheme so contrary to the spirit of the Bankruptcy Act *should not have been granted by an ex parte order* . . . .

596 F.2d at 1098-1099 (emphasis added).

The bankruptcy court in *Monach* similarly held that notice to creditors was insufficient. In *dicta*, the bankruptcy court only speculated that the *Texlon* court would have held that cross-collateralization was forbidden. 41 Bankr. at 862.

The facts and holdings of both *Texlon* and *Monach* also contrast sharply with this case. Neither case involved Section 364(e) or Rule 805. Both of those cases involved *ex parte* orders. Notice and opportunity for creditors to be heard were held to be inadequate. Here, all three courts below explicitly found that Petitioners received sufficient notice and opportunity to be heard. Neither case therefore has any relevance to the issues presented here.

(Footnote continued from preceding page.)

Marquette operations would have to close, and that the Banks would not accede to less favorable terms. Verified Motion, para. 10-14. The Debtors' chief financial officer testified concerning the Debtors' inability to obtain alternative financing. 10/16/84 Tr. at 80, 83-84, 91-92; 12/21/84 Tr. at 27-28, 43-44. The record amply supports the Bankruptcy Court's finding that the Amended Order was in the best interests of the general creditor body, particularly insofar as it preserved the Debtors' going concern value.

C. The Terms Of The Amended Order Are Proper Even When Viewed As Constituting Cross-Collateralization

If this Court were to assume that the Amended Order actually contains cross-collateralization, it would find that it was justified to the extent it existed here. Petitioners' appeal therefore was properly dismissed even under Petitioners' incorrect and narrow view of Section 364(e).

Petitioners rely almost exclusively upon arguments contained in one law review article to claim that the Bankruptcy Code prohibits cross-collateralization.[23] The argument is that because Section 364 only applies to post-petition borrowing, it contains an exclusive list of terms for financing orders that preclude all other terms, including cross-collateralization, that affect pre-petition debt. Petitioners' premise does not support their simplistic conclusion. Of course Section 364 refers only to post-petition borrowing. There is no need for the bankruptcy court to authorize pre-petition borrowing because that occurs prior to the filing of a bankruptcy petition. But to say that Section 364 therefore cannot affect pre-petition debt in any way is an unfounded leap in logic.

Nor does the legislative history support Petitioners' conclusion that Section 364 contains an exclusive list of terms for financing orders. The only legislative authority cited by Petitioners is one statement from the House and Senate Reports that "[Section 364] governs all obtaining of credit and in-

---

[23] Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. Cal. L.Rev. 109, 140 (1988). This article stands alone as the only criticism of cross-collateralization other than the *dicta* in the *Texlon* and *Monach* decisions. *Cf.*, Weintraub and Resnick, *Cross-Collateralization of Pre-petition Indebtedness as an Inducement for Post-petition Financing: A Euphemism Comes Of Age*, 14 U.C.C. L.J. 86, 90-91 (1981); Bohm, *The Legal Justification for the Proper Use of Cross-Collateralization Clauses in Chapter 11 Bankruptcy Cases*, 59 Am. Bankr. L.J. 289, 294-301 (1985).

curring of debt by the estate." Without any logic or explanation, Petitioners reach their conclusion merely by repeating the statement in its negative form—that "there are no methods of obtaining financing which are not covered by Section 364."

Petitioners' conclusion is plainly wrong because it ignores the context in which the statement was made. Under the Bankruptcy Act, provisions regarding financing of reorganizing debtors were scattered throughout Chapters X, XI and XII.[24] All financing provisions under the Bankruptcy Code are found in Section 364. The only fair interpretation of the legislative authority cited by the Petitioners is that all of the Bankruptcy Code's financing provisions have been consolidated in Section 364 rather than spread among other sections. It is not that Section 364 contains an exclusive listing of financing terms. That narrow construction would be inconsistent with normal bankruptcy practice and would unnecessarily restrict financing possibilities for debtors.[25] To the contrary, Congress did state

---

[24] *See, e.g.*, Sections 116(2), 344 and 446 of the Bankruptcy Act of 1898.

[25] For example, Petitioners' strained interpretation of Section 364 would exclude all terms not specified in Section 364 from financing orders. Financing orders, however, frequently are lengthy documents containing a panoply of terms (*e.g.*, interest rates; how funds are to be advanced; covenants of the debtor; payment terms; remedies upon default; liquidated damages clauses; waivers of service, jury trial rights and bond requirements; *etc.*), most of which protect the post-petition lender. Petitioners surely do not suggest that these terms are unenforceable, too.

Petitioners' restriction of Section 364 to post-petition terms would require valuation of a lender's collateral as of the filing date, and then separation of that collateral into pre-petition and post-petition portions, prior to the entry of financing orders. For operating businesses with substantial inventory, both requirements would be impractical, if not impossible. There rarely is time or opportunity in the initial stages of a Chapter 11 case to make such a valuation prior to obtaining any post-petition financing, and it could be a very expensive and cumbersome procedure for an already financially troubled business. Segregation of inventory indeed may be impossible for certain types of businesses and would present substantial bookkeeping problems for all businesses. The result would be reduced incentives for lenders to continue financing debtors and for debtors to resort to Chapter 11. In short, the application of Petitioners' theories would be contrary to Chapter 11's goal of the reorganization of troubled businesses.

that Section 364 "is much broader" than pre-Code financing law.[26] It did not say that it was narrower. Substance, not semantics, should govern statutory interpretation.

VI. PETITIONERS WERE NOT DENIED DUE PROCESS

Petitioners first due process argument is that they received insufficient notice of the December 21, 1984, hearing in which they themselves participated. Under Section 364, a debtor may incur debt other than in the ordinary course of business only "after notice and a hearing," which Section 102(1) of the Bankruptcy Code defines as:

> . . . after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate under the circumstances . . . .

The Bankruptcy Court's determination that an emergency existed immediately prior to entry of the Amended Order finds more than adequate support in the record. As the District Court stated:

> This Court is satisfied that the bankruptcy court committed no error in holding the emergency hearing upon short notice. From the statements contained in the verified petition, and from his knowledge of the case gleaned from past proceedings between these very same parties, the Bankruptcy Judge could very safely operate under the assumption that an emergency situation was present.

65 Bankr. at 362. The Sixth Circuit agreed with the District Court's conclusion. 834 F.2d at 605.

---

[26] House Report No. 95-595, 95th Cong., 1st Sess. 346-347 (1977); Senate Report No. 95-989, 95th Cong., 2d Sess. 57-58 (1978).

Petitioners also could have challenged the entry of Amended Order in any of several ways. Petitioners could have sought a stay pending appeal immediately after entry of the Amended Order on December 21, 1984. Instead, they chose to wait until July 5, 1985, to do so. Even when they sought a stay, they refused to offer to post a bond. Petitioners also could have sought a new trial pursuant to Bankruptcy Rule 9023 and Rule 59 of the Federal Rules of Civil Procedure, or filed a motion for relief from the Amended Order pursuant to Bankruptcy Rule 9024 and Rule 60 of the Federal Rules of Civil Procedure. As the Sixth Circuit concluded, "[Petitioners] took advantage of none of these available procedures, and therefore cannot now claim a denial of due process." 834 F.2d at 604.

Petitioners' last due process argument is that the Bankruptcy Court entered the Amended Order without conducting an adversary proceeding. But as Petitioners themselves note, Rule 7001 does not apply to post-petition financing orders. This was a financing order. Rule 7001 therefore does not apply.[27]

Importantly, all the Petitioners had to do to initiate an adversary proceeding was to ask for affirmative relief in their objection to the Banks' claims. Under Bankruptcy Rule 3007, the dispute would have been converted automatically to an adversary proceeding. Petitioners never did so in the eleven months that elapsed between the Petition Date and the entry of the Amended Order.

Petitioners nevertheless claim that they could not have received due process without an adversary proceeding. The

---

[27] To suggest, as Petitioners do, that "the apparent conflict between the notice and hearing requirements found in Bankruptcy Rule 7001 and Section 364 can be reconciled by the interpretation of Section 364 [as an exclusive list of permissible terms] asserted by the Committee" merely begs the question. The apparent conflict can also be resolved by resort to the plain meaning of Rule 7001: disputed terms of a post-petition financing order need not be resolved by the summons and complaint process of adversary proceedings.

only substantial difference between the procedure for contested matters, which was followed here, and the procedure for adversary proceedings is that the latter requires the service of a summons and complaint.[28] The service of a summons and complaint would not have provided the Petitioners with any more due process than did the service of the Verified Motion. Under either procedure, the Bankruptcy Court was free to deem the notice appropriate—either under Section 102(1) of the Bankruptcy Code or by reducing the time to respond to an adversary proceeding under Bankruptcy Rule 9006(c)—and to grant the relief requested. Petitioners therefore could not have been prejudiced by the procedure that was used.

VII. THE DECISION BELOW DOES NOT CONFLICT WITH DECISIONS OF THIS COURT

Finally, Petitioners argue that the decision below conflicts with applicable decisions of this Court. Petitioners contend that the Sixth Circuit's construction of Section 364(e) conflicts both with this Court's rules of statutory construction and with this Court's ruling concerning the settlement of bankruptcy disputes. Neither contention provides a reason to grant the petition.

A. The Plain Language Of The Bankruptcy Code Supports The Lower Court's Opinion

Petitioners contend that liens granted pursuant to Section 364(c) are limited to security for post-petition advances, and that any other term of a financing order is therefore not an "authorization under this section to obtain credit" entitled to Section 364(e) protection. Nothing in Section 364(c) or the legislative history indicates that Section 364 contains the exclusive list of terms available to post-petition lenders. *See* pp.

---

[28] Bankruptcy Rule 9014, which applies to contested matters, incorporates virtually the same rules concerning process, discovery and enforcement of judgments that apply in adversary proceedings.

24-26, *supra*. The "authorization under this section to obtain credit" is the financing order itself, taken in its entirety. This was the holding of the Sixth Circuit in this case and the Ninth Circuit in *Adams Apple*. In fact, the Sixth Circuit concluded that the Amended Order did not "exceed the intended scope of Section 364 . . . Under the circumstances of this case, this condition seems to have been necessary to induce the Banks to extend more credit, which is the underlying purpose of Section 364." 834 F.2d at 604. The language and purpose of Section 364 therefore support, rather than contradict, the result below.

The plain language of the statute directly contradicts Petitioners' argument in another way. Section 364(e) not only protects against "reversal" but against "modification" of financing orders. No matter how Petitioners frame their argument, the effect of their argument is to modify the terms of the financing order itself. Under Section 364(e), that cannot be done without a stay.

B. This Court's *TMT Trailer* Decision Involves The Substance Of The Settlement Itself, Not Procedure

The Amended Order does use the verb "settle" with respect to the Debtors' agreement not to challenge the Banks' security interests. Under the doctrine first enunciated by this Court in *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968), bankruptcy courts are to determine whether the merits of a proposed settlement are fair and equitable.

The question here is whether dismissal of the appeal was proper, not whether the Amended Order itself was wrongfully entered. The merits of the Amended Order will be addressed only if this Court decides that the appeal was wrongfully dismissed. Only then will the District Court consider whether to apply the standards of the *TMT Trailer* decision to the Bankruptcy Court's ruling. It simply is not the issue now. Once again, Petitioners have presented the wrong issue in their attempt to justify issuance of the writ.

CONCLUSION

Petitioners' appeal of the Amended Order was properly dismissed by a straightforward application of Section 364(e) of the Bankruptcy Code because Petitioners failed to obtain a stay pending appeal. Dismissal was proper despite possible questions about one term of the Amended Order itself. There is no disagreement in the courts on that issue, and longstanding Congressional policy strongly supports that result. The Amended Order reflects a commercially reasonable *quid pro quo* that the Bankruptcy Court carefully judged to be in the best interests of all parties, including Petitioners. It was not an abuse of unsecured creditors—by denial of due process, cross-collateralization or otherwise—that requires this Court's attention.

The petition therefore should be denied.

Respectfully submitted,

DAVID F. HEROY
(Counsel of Record)
THOMAS C. WOLFORD
GARDNER, CARTON & DOUGLAS
Quaker Tower
321 N. Clark Street
Chicago, Illinois 60610-4795
(312) 644-3000

Of Counsel:
SNYDER, VALENTINE & RITCHIE
BUTCH, QUINN, ROSEMURGY, JARDIS & VALKANOFF

July 29, 1988